

CHANGES IN RATES DURING A TAXABLE
YEAR**§ 1.15-1 Changes in rate during a taxable year.**

(a) Section 21 applies to all taxpayers, including individuals and corporations. It provides a general rule applicable in any case where (1) any rate of tax imposed by chapter 1 of the Code upon the taxpayer is increased or decreased, or any such tax is repealed, and (2) the taxable year includes the effective date of the change, except where that date is the first day of the taxable year. For example, the normal tax on corporations under section 11(b) was decreased from 30 percent to 22 percent in the case of a taxable year beginning after December 31, 1963. Accordingly, the tax for a taxable year of a corporation beginning on January 1, 1964, would be computed under section 11(b) at the new rate without regard to section 21. However, for any taxable year beginning before January 1, 1964, and ending on or after that date, the tax would be computed under section 21. For additional circumstances under which section 21 is not applicable, see paragraph (k) of this section.

(b) In any case in which section 21 is applicable, a tentative tax shall be computed by applying to the taxable income for the entire taxable year the rate for the period within the taxable year before the effective date of change, and another tentative tax shall be computed by applying to the taxable income for the entire taxable year the rate for the period within the taxable year on or after such effective date. The tax imposed on the taxpayer is the sum of—

(1) An amount which bears the same ratio to the tentative tax computed at the rate applicable to the period within the taxable year before the effective date of the change that the number of days in such period bears to the number of days in the taxable year, and

(2) An amount which bears the same ratio to the tentative tax computed at the rate applicable to the period within the taxable year on and after the effective date of the change that the number of days in such period bears to the number of days in the taxable year.

(c) If the rate of tax is changed for taxable years “beginning after” or “ending after” a certain date, the following day is considered the effective date of the change for purposes of section 21. If the rate is changed for taxable years “beginning on or after” a certain date, that date is considered the effective date of the change for purposes of section 21. This rule may be illustrated by the following examples:

Example 1. Assume that the law provides that a change in a certain rate of tax shall be effective only with respect to taxable years beginning after December 31, 1969. The effective date of change for purposes of section 21 is January 1, 1970, and section 21 must be applied to any taxable year which begins before and ends on or after January 1, 1970.

Example 2. Assume that the law provides that a change in a certain rate of tax shall be applicable only with respect to taxable years ending after December 31, 1970. For purposes of section 21, the effective date of change is January 1, 1971, and section 21 must be applied to any taxable year which begins before and ends on or after January 1, 1971.

Example 3. Assume that the law provides that a change in a certain rate of tax shall be effective only with respect to taxable years beginning on or after January 1, 1971. The effective date of change for purposes of section 21 is January 1, 1971, and section 21 must be applied to any taxable year which begins before and ends on or after January 1, 1971.

(d) If a tax is repealed, the repeal will be treated as a change of rate for purposes of section 21, and the rate for the period after the repeal (for purposes of computing the tentative tax with respect to that period) will be considered zero. For example, the Tax Reform Act of 1969 repealed section 1562, which imposed a 6 percent additional tax on controlled corporations electing multiple surtax exemptions, effective for taxable years beginning after December 31, 1974. For such controlled corporations having taxable years beginning in 1974 and ending in 1975, the rate for the period ending before January 1, 1975, would be 6 percent; the rate for the period beginning after December 31, 1974, would be zero. However, subject to the rules stated in this section, section 21 does not apply to the imposition of a new tax. For example, if a new tax is imposed for taxable years beginning on or after July 1, 1972, a computation

under section 21 would not be required with respect to such new tax in the case of taxable years beginning before July 1, 1972, and ending on or after that date. If the effective date of the imposition of a new tax and the effective date of a change in rate of such tax fall in the same taxable year, section 21 is not applicable in computing the taxpayer's liability for such tax for such year unless the new tax is expressly imposed upon the taxpayer for a portion of his taxable year prior to the change in rate.

(e) If a husband and wife have different taxable years because of the death of either spouse, and if a joint return is filed with respect to the taxable year of each, then, for purposes of section 21, the joint return shall be treated as if the taxable years of both spouses ended on the date of the closing of the surviving spouse's taxable year. See section 6013 (c), relating to treatment of joint return after death of either spouse. Accordingly, if a change in the rate of tax is effective during the taxable year of the surviving spouse, the tentative taxes with respect to the joint return shall be computed on the basis of the number of days during which each rate of tax was in effect for the taxable year of the surviving spouse.

(f) Section 21 applies whether or not the taxpayer has a taxable year of less than 12 months. Moreover, section 21 applies whether or not the taxable income for a taxable year of less than 12 months is required to be placed on an annual basis under section 443. If the taxable income is required to be computed under section 443(b) then the tentative taxes under section 21 are computed as provided in paragraph (1) or (2) of section 443(b) and are reduced as provided in those paragraphs. The tentative taxes so computed and reduced are then apportioned as provided in section 21(a)(2) to determine the tax for such taxable year as computed under section 21.

(g) If a taxpayer has made the election under section 441(f) (relating to computation of taxable income on the basis of an annual accounting period varying from 52 to 53 weeks), the rules provided in section 441(f)(2) shall be applicable for purposes of determining

whether section 21 applies to the taxable year of the taxpayer. Where a taxpayer has made the election under section 441(f) and where section 21 applies to the taxable year of the taxpayer the computation under section 21(a)(2) shall be made upon the basis of the actual number of days in the taxable year and in each period thereof.

(h)(1) Section 21 is applicable only if the rate of tax imposed by chapter 1 changes. Sections in which rates of tax are specified or incorporated by reference include the following: 1, 2, 3, 11, 511, 531, 541, 821, 831, 871, 881, 1201, and 1348 (for taxable years beginning after December 31, 1970). Except as provided in subparagraph (3) of this paragraph, section 21 is not applicable with respect to changes in the law relating to deductions from gross income, exclusions from or inclusions in gross income, or other items taken into account in determining the amount or character of income subject to tax. Moreover, section 21 is not applicable with respect to changes in the law relating to credits against the tax or with respect to changes in the law relating to limitations on the amount of tax. Section 21 is applicable, however, to all those computations specified in the section providing the rate of tax which are implicit in determining the rate. For example, if one of the tax brackets in the tax tables under section 3 were to be changed, section 21 would be applicable to that change. Thus, if the bracket relating to "at least \$4,200 but not less than \$4,250" for heads of households should be changed to increase or decrease the last sum specified, with corresponding changes being made in subsequent brackets, section 21 would be applicable. The enactment of sections 1561 and 1562 is considered a change in section 11(d) which constitutes a change in rate for the period ending after December 31, 1963. The amendment of section 1561 and the repeal of section 1562 by the Tax Reform Act of 1969 is considered a change in section 11(d) which constitutes a change in rate for the period ending after December 31, 1974. The repeal of the 2 percent additional tax imposed under section 1503 on corporations filing consolidated returns constitutes a change in rate for the period

ending after December 31, 1963. The addition to the Code of section 1348 (relating to 50 percent maximum rate on earned income) is a change in rate to which section 21(a) is applicable. The amendment of section 11(d) by the Tax Reduction Act of 1975 which increases to \$50,000 the surtax exemption for a taxable year ending during 1975 constitutes a change in rate for such portion of the taxable year (if less than the entire taxable year) as follows December 31, 1974. Similarly, the return of the surtax exemption to \$25,000 for a taxable year ending during 1976 constitutes a change in rate for such portion of the taxable year (if less than the entire taxable year) as follows December 31, 1975.

(2) Ordinarily, both the old and the new rates are applied to the same amount of taxable income. However, where the rate of tax is itself taken into account in determining taxable income (for example, the special deduction for Western Hemisphere trade corporations under section 922), the taxable income used in determining the tentative tax employing the rate before the effective date of change shall be determined by reference to that rate of tax, and the taxable income for the purpose of determining the tentative tax employing the rate for the period on and after the effective date of the change shall be determined by reference to the new tax rate.

(3) Section 21 is applicable with respect to changes in the law relating to the standard deduction for individuals provided in part IV of subchapter B and to the deduction for personal exemptions for individuals provided in part V of subchapter B.

(i) If the rate of tax changes more than once during the taxable year, section 21 is applicable to each change in rate. For example, if the rate of normal tax changed for taxable years beginning on or after March 1, 1954, and changed again for taxable years beginning on or after June 1, 1954, section 21 requires computation of 3 tentative taxes for any taxable year which began before March 1, 1954, and ended on or after June 1, 1954: One tentative tax at the rate in effect before the March 1 change; another tentative tax at the rate in effect from March 1 to May 31;

and a third tentative tax at the rate in effect from June 1 to the end of the taxable year. The proportion of each such tentative tax taken into account in determining the tax imposed on the taxpayer is computed by reference to the portion of the taxable year before March 1, 1954, by reference to the portion of the taxable year from March 1, 1954, through May 31, 1954, and by reference to the portion of the taxable year from June 1, 1954, to the end of the taxable year, respectively.

(j)(1) If a change in the rate of one tax imposed by chapter 1 of the Code does not affect the amount of other taxes imposed by chapter 1 of the Code the other taxes may be determined without regard to section 21 and section 21 will be applied only to the tax for which a change in rate is made. However, if the change of rate of one tax does affect the amount of other taxes imposed under chapter 1 of the Code, then the computation of the taxes under chapter 1 of the Code so affected shall be made by applying section 21. For example, if section 1201 applies to an individual taxpayer for a taxable year containing the effective date of a change in a rate of tax provided in section 1, then under section 21 the taxpayer must compute a tentative tax for each period for which a different rate of tax is effective under section 1. The tentative tax for each such period as computed under section 1201 will reflect the rate of tax provided by section 1 for such period.

(2) In certain cases chapter 1 of the Code provides that the particular tax to be imposed upon the taxpayer shall be one of several taxes, the basis of selection being the tax that is greater or lesser. See, for example, sections 821 and 1201. If in any such case the rate of any one of these taxes changes, then the tentative taxes computed as provided by section 21 for each period shall be computed employing the tax selected in accordance with the general rule of selection for such a case, at the rate of tax in effect for such period. Thus, if a change in the rate of the alternative tax under section 1201 is such that the alternative tax under section 1201 is applicable if the old rate is used and is not applicable if the new rate is used, one tentative tax will consist of

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the alternative tax under section 1201 and the other tentative tax will consist of the tax imposed by the other applicable sections of chapter 1 of the Code. The two tentative taxes so computed are then prorated in accordance with section 21(a)(2) and the sum of the proportionate amounts is the tax imposed for the taxable year under chapter 1 of the Code. See the examples in paragraph (n) of this section.

(k) Section 21 does not apply in the following situations:

(1) The provisions of section 21 do not apply to the imposition of the tax surcharge by section 51. The proration rules of section 51(a) apply in the case of a taxable year ending on or after the effective date of the surcharge and beginning before July 1, 1970.

(2) The provisions of section 21 do not apply to the imposition of the minimum tax for tax preferences by section 56. The proration rules of section 301(c) of the Tax Reform Act of 1969 (83 Stat. 586) apply in the case of a taxable year beginning in 1969 and ending in 1970.

(l) In computing the number of days each rate of tax is in effect during the taxable year for purposes of section 21(a)(2), the effective date of the change in rate shall be counted in the period for which the new rate is in effect.

(m) Any credits against tax, and any limitation in any credit against tax, shall be based upon the tax computed under section 21. For credits against tax, see part IV (section 31 and following), subchapter A, chapter 1 of the Code.

(n) The application of section 21 may be illustrated by the following examples: (See also the examples in § 1.1561-2A(a)(3).)

Example 1. A, a married taxpayer filing a joint return, reports his income on the basis of a fiscal year ending June 30. For his fiscal year ending June 30, 1970, A reports taxable income (exclusive of capital gains and losses) of \$50,000 and net long-term capital gain (section 1201 gain (net capital gain for taxable years beginning after December 31, 1976)) of \$75,000. The rate of tax on capital gains under section 1201(b) relating to the alternative tax has been increased from 25 percent to a maximum rate of 29½ percent with respect to gain in excess of \$50,000 and the effective date of the change in rate is January 1, 1970.

The income tax for the taxable year ended June 30, 1970, would be computed under section 21 as follows:

TENTATIVE TAX	
Taxable income exclusive of capital gains and losses ..	\$50,000
Long-term capital gain	75,000
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	125,000
Deduct 50% of long-term capital gain ...	37,500
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Taxable income	87,500
Tax under section 1 (1969 and 1970 rates)	37,690
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ALTERNATIVE TAX UNDER SECTION 1201(b) (1969 RATES)	
Taxable income (\$50,000+50% of \$75,000)	\$87,500
Less 50% of long-term capital gain ...	37,500
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Taxable income exclusive of capital gains	50,000
Partial tax (tax on \$50,000)	17,060
Plus 25% of \$75,000	18,750
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Alternative tax under section 1201(b) at 1969 rates	35,810
ALTERNATIVE TAX UNDER SECTION 1201(b) (1970 RATES)	
STEP I	
Taxable income (\$50,000 + 50% of \$75,000)	\$87,500
Deduct 50% of net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976)	37,500
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	50,000
Tax on \$50,000 (taxable income exclusive of capital gains)	\$17,060
STEP II	
(a) Net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976)	75,000
(b) Subsection (d) gain	50,000
25% of \$50,000 (lesser of (a) or (b))	12,500
STEP III	
(c) 29½% of \$25,000 (excess of (a) over (b))	7,375
(d) Ordinary income	\$50,000

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50% of net section 1201 gain (net capital gain for taxable years beginning after December 31, 1976)	37,500	
	<u>87,500</u>	
Tax on \$87,500	\$37,690	
Ordinary income	\$50,000	
50% of subsection (d) gain	25,000	
	<u>75,000</u>	
Tax on \$75,000	30,470	
Difference	<u>7,220</u>	
Lesser of (c) or (d) ...	<u>\$7,220</u>	
Alternative tax (total of 3 steps) at rates effective on and after January 1, 1970	<u>36,780</u>	

Since the alternative tax is less than the tax imposed under section 1 for both the period in 1969 and the period in 1970, the alternative tax applies for both periods. Thus, since the effective date of the change in the rate of tax on capital gains is January 1, 1970, the old rate of alternative tax is effective for 184 days of the taxable year and the new rate of alternative tax is effective for 181 days of the taxable year. The alternative taxes are apportioned as follows:

1969—184/365 of \$35,810	\$18,052.16	
1970—181/365 of \$36,780	<u>18,238.85</u>	
	36,291.01	
Tax surcharge (See § 1.51-1(d)(1)(i))	<u>2,729.28</u>	
Total tax for the taxable year	<u>39,020.29</u>	

Example 2. B, a single individual not a head of a household, has a taxable year ending March 31. For the taxable year ending March 31, 1971, B has adjusted gross income of \$18,500. His computation of the tax imposed is as follows:

1970 TENTATIVE TAX		
Adjusted gross income	\$18,500.00	
Less:		
Standard deduction	\$1,000.00	
Personal exemption	625.00	1,625.00
Taxable income under 1970 deduction provisions	<u>16,875.00</u>	
Tax on \$16,875 (1970 rates):		
Tax on first \$16,000	4,330.00	
42 percent of \$875	<u>367.50</u>	
Tentative tax at rates and deduction provisions effective on or after January 1, 1970	<u>4,697.50</u>	
1971 TENTATIVE TAX		
Adjusted gross income	\$18,500.00	
Less:		
Standard deduction	\$1,500	

Personal exemption	650	2,150.00
Taxable income under 1971 deduction provisions	<u>16,350.00</u>	
Tax on \$16,350 (1971 rates):		
Tax on first \$16,000	3,830	
34 percent of \$350	<u>119</u>	
Tentative tax at rates and deduction provisions effective on or after January 1, 1971	<u>3,949.00</u>	
The 1970 and 1971 tentative taxes are apportioned as follows:		
1970—275/365 of \$4,697.50 ..	3,539.21	
1971—90/365 of \$3,949.00	<u>973.73</u>	
	4,512.94	
Tax surcharge (see § 1.51-1(d)(1)(i))	<u>56.26</u>	
Total tax for the taxable year	<u>4,569.20</u>	

Example 3. H and W, husband and wife, have a foster child, C, who qualifies as a dependent under section 152(b)(2) for the period beginning after December 31, 1969. H and W file a joint return on the basis of a taxable year ending August 31. For the taxable year ending August 31, 1970, H and W have adjusted gross income of \$12,500. Their computation of the tax imposed is as follows:

1969 TENTATIVE TAX		
Adjusted gross income	\$12,500.00	
Less:		
Standard deduction	\$1,000.00	
Personal exemption (2) ...	1,200.00	2,200.00
Taxable income under 1969 deduction provisions	<u>10,300.00</u>	
Taxable income reduced by one-half	<u>5,150.00</u>	
Tax on \$5,150 (1969 rates):		
Tax on first \$4,000	\$690.00	
22 percent of \$1,150	<u>253.00</u>	943.00
Twice the tax on \$5,150	<u>1,886.00</u>	
Tentative tax at rates and deduction provisions effective on or after January 1, 1969	<u>1,886.00</u>	
1970 TENTATIVE TAX		
Adjusted gross income	\$12,500.00	
Less:		
Standard deduction	\$1,000.00	
Personal exemption (3) ...	1,875.00	2,875.00
Taxable income under 1970 deduction provisions	<u>\$9,625.00</u>	
Tax on \$9,625 (1970 rates):		
Tax on first \$8,000	\$1,380.00	
22 percent of \$1,625	<u>357.50</u>	
Tentative tax at rates and deduction provisions effective on or after January 1, 1970	<u>1,737.50</u>	

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The 1969 and 1970 tentative taxes are apportioned as follows:

1969—122/365 of \$1,886	\$630.39	
1970—243/365 of \$1,737.50 ..	1,156.75	
	1,787.14	
Tax surcharge (see § 1.51-1(d)(1)(i))	104.05	
Total tax for the taxable year	1,891.19	

Example 4. B, a single individual with one exemption, reports his income on the basis of a fiscal year ending June 30. For fiscal year ending June 30, 1971, B reports adjusted gross income of \$250,000, consisting of earned net income of \$240,000 and investment income of \$10,000. In addition, on April 24, 1971, stock was transferred to B pursuant to his exercise of a qualified stock option, and the fair market value of such stock at that time exceeded the option price by \$175,000. This \$175,000 constitutes an item of tax preference described in section 57(a)(6). B claims itemized deductions in the amount of \$34,000. By reason of section 1348, the maximum rate of tax on earned taxable income for a taxable year beginning after 1970 but before 1972 is 60 percent. The income tax for the taxable year ending June 30, 1971, would be computed under section 21 as follows:

1970 TENTATIVE TAX			
Adjusted gross income	\$250,000.00		
Less:			
Itemized deductions	\$34,000.00		
Personal exemption	625.00	34,625.00	
Taxable income under 1970 deduction provisions	215,375.00		
Tax on \$215,375 (1970 rates)			
Tax on first \$100,000	\$55,490.00		
70 percent of \$115,375	80,762.50		
Tentative tax at rates and deduction provisions effective on or after January 1, 1970	136,252.50		
Minimum tax:			
Total tax preference items	175,000.00		
Less:			
Exemption	\$30,000.00		
Income tax	136,252.50	166,252.50	
Subject to 10 percent tax ..	8,747.50		
10 percent tax	874.75		
Total tentative tax (\$136,252.50 + \$874.75)	137,127.25		

1971 TENTATIVE TAX			
Adjusted gross income	\$250,000.00		
Less:			
Itemized deductions	\$34,000.00		
Personal exemption	650.00	34,650.00	

Taxable income under 1971 deduction provisions	215,350.00
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(a) Tax on highest amount of taxable income on which rate does not exceed 60 percent (\$50,000) (1971 rates) ...	20,190.00
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(b) Earned taxable income:	
(\$215,350 × \$240,000 / \$250,000)	\$206,736.00
Less: Tax preference offset: (\$175,000 - \$30,000)	145,000.00
	61,736.00

(c) 60% of the amount by which \$61,736 exceeds \$50,000	7,041.60
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(d) Tax on \$215,350 (1971 rates)	
Tax on first \$100,000	53,090.00
70% of \$115,350	80,745.00
Total	133,835.00

(e) Tax on \$61,736 (1971 rates)	
Tax on first \$60,000	26,390.00
64% of \$1,736	1,111.04
Total	27,501.04

(f) Excess of \$133,835 over \$27,501.04	106,333.96
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Tentative tax (total of Steps (a), (c), and (f)) at rates and deduction provisions effective on or after January 1, 1971	133,565.56
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Minimum tax:		
Total tax preference items	175,000.00	
Less:		
Exemption	\$30,000.00	
Income tax	133,565.56	163,565.56
Subject to 10 percent tax	\$11,434.44	
10 percent tax	1,143.44	

Total tentative tax (\$133,565.56 + \$1,143.44)	134,709.00
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The 1970 and 1971 tentative taxes are apportioned as follows:	
1970—184/365 of \$137,127.25	69,127.16
1971—181/365 of \$134,709	66,800.90

Total tax for the taxable year	135,928.06
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Example 5. The surtax exemption of corporation M (one of 4 subsidiary corporations of W corporation), which files its income tax

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returns on the basis of a fiscal year ending March 31, 1964, is less than \$25,000, by reason of section 1561 of the Code applicable to taxable years ending after December 31, 1963, and beginning before January 1, 1975. The taxable income of corporation M is \$100,000, and the amount of the surtax exemption determined under the new rule for the 1964 taxable year is \$5,000 (\$25,000÷5). M's income tax liability for the taxable year ending March 31, 1964, is computed as follows:

1963 TENTATIVE TAX	
Taxable income	\$100,000
Normal tax on \$100,000 (1963 rates) 30 percent of \$100,000	\$30,000
Surtax on \$75,000 (1963 rates and \$25,000 surtax exemption) 22 percent of \$75,000	16,500
Total tentative tax at rates and surtax exemption effective before January 1, 1964	46,500

1964 TENTATIVE TAX	
Taxable income	\$100,000
Normal tax on \$100,000 (1964 rates) 22 percent of \$100,000	\$22,000
Surtax on \$95,000 (1964 rates and a \$5,000 surtax exemption) 28 percent of \$95,000	26,600
Total tentative tax at rates and surtax exemption effective after January 1, 1964	48,600

The 1963 and 1964 tentative taxes are apportioned as follows:	
1963—275/366 of \$46,500	34,938.52
1964—91/366 of \$48,600	12,083.61
Total tax for the taxable year	47,022.13

M has the same amount of taxable income in 1965. Its income tax liability for the fiscal year ending March 31, 1965, is computed as follows:

1964 TENTATIVE TAX	
Taxable income	\$100,000
Normal tax on \$100,000 (1964 rates) 22 percent of \$100,000	\$22,000
Surtax on \$95,000 (1964 rates and a \$5,000 surtax exemption) 28 percent of \$95,000	26,600
Total tentative tax at the 1964 rates	48,600

1965 TENTATIVE TAX	
Taxable income	\$100,000

Normal tax on \$100,000 (1965 rates) 22 percent of \$100,000	\$22,000
Surtax on \$95,000 (1965 rates and a \$5,000 surtax exemption) 26 percent of \$95,000	24,700
Total tentative tax at the 1965 rates	46,700

The 1964 and 1965 tentative taxes are apportioned as follows:	
1964—275/366 of \$48,600	\$36,616.44
1965—90/366 of \$46,700	11,515.07
Total tax for the taxable year	48,131.51

Example 6. Assume the same facts as in example (5), except that M elected the additional tax under section 1562 for its fiscal year ending March 31, 1964. M's tax liability is completed as follows:

1963 TENTATIVE TAX	
Taxable income	\$100,000
Normal tax on \$100,000 (1963 rates) 30 percent of \$100,000	\$30,000
Surtax on \$75,000 (1963 rates and \$25,000 surtax exemption) 22 percent of \$75,000	16,500
Total tentative tax at rates and surtax exemption effective before January 1, 1964	46,500

1964 TENTATIVE TAX	
Taxable income	\$100,000
Normal tax on \$100,000 (1964 rates) 22 percent of \$100,000	\$22,000
Surtax on \$75,000 (1964 rates and \$25,000 surtax exemption) 28 percent of \$75,000	21,000
Additional tax on \$25,000 6 percent of \$25,000	1,500
Total tentative tax at rates and surtax exemption effective on and after January 1, 1964 ..	44,500

The 1963 and 1964 tentative taxes are apportioned as follows:	
1963—275/366 of \$46,500	\$34,938.52
1964—91/366 of \$44,500	11,064.21
Total tax for the taxable year	46,002.73

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Example 7. Corporation N files its income tax returns on the basis of a fiscal year ending June 30. For its taxable year ending in 1976, the taxable income of N is \$100,000. N's income tax liability is determined for the period July 1, 1975, through December 31, 1975, by taking into account two rates of normal tax under section 11(b)(2) (A) and (B) and the increase to \$50,000 in the surtax exemption under section 11(d). For the period January 1, 1976, through June 30, 1976, N's income tax liability is determined by taking into account the single normal tax rate under section 11(b)(1) and the \$25,000 surtax exemption under section 11(d). N's tax liability for the taxable year ending June 30, 1976, is computed as follows:

1975 TENTATIVE TAX	
Taxable income	\$100,000
Normal tax on \$100,000 (1975 rates) 20 per- cent of \$25,000	\$5,000
22 percent of \$75,000	16,500
Surtax on \$50,000 (1975 rates and \$50,000 sur- tax exemption) 26 per- cent of \$50,000	13,000
Total tentative tax at rates and surtax exemption effec- tive on and after January 1, 1975 ..	34,500
1976 TENTATIVE TAX	
Taxable income	\$100,000
Normal tax on \$100,000 (1976 rates) 22 per- cent of \$100,000	\$22,000
Surtax on \$75,000 (1976 rates and \$25,000 sur- tax exemption) 26 per- cent of \$75,000	19,500
Total tentative tax at rates and surtax exemption effec- tive on and after January 1, 1976 ..	41,500
The 1975 and 1976 ten- tative taxes are apor- tioned as follows:	
1975—184/366 of \$34,500	\$17,344
1976—182/366 of \$41,500	20,637
Total tax for the tax- able year	37,981

(Secs. 1561(a) (83 Stat. 599; 26 U.S.C. 1561(a)) of the Internal Revenue Code)

[T.D. 6500, 25 FR 11402, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7164, 37 FR 4190, Feb. 29, 1972; T.D. 74-13, 41 FR 12639, Mar. 26, 1976; T.D. 7528, 42 FR 64694, Dec. 28, 1977; T.D. 7728, 45 FR 72651, Nov. 3, 1980. Redesignated by T.D. 9354, 72 FR 45341, Aug. 14, 2007]

§ 1.21-1 Expenses for household and dependent care services necessary for gainful employment.

(a) *In general.* (1) Section 21 allows a credit to a taxpayer against the tax imposed by chapter 1 for employment-related expenses for household services and care (as defined in paragraph (d) of this section) of a qualifying individual (as defined in paragraph (b) of this section). The purpose of the expenses must be to enable the taxpayer to be gainfully employed (as defined in paragraph (c) of this section). For taxable years beginning after December 31, 2004, a qualifying individual must have the same principal place of abode (as defined in paragraph (g) of this section) as the taxpayer for more than one-half of the taxable year. For taxable years beginning before January 1, 2005, the taxpayer must maintain a household (as defined in paragraph (h) of this section) that includes one or more qualifying individuals.

(2) The amount of the credit is equal to the applicable percentage of the employment-related expenses that may be taken into account by the taxpayer during the taxable year (but subject to the limits prescribed in § 1.21-2). *Applicable percentage* means 35 percent reduced by 1 percentage point for each \$2,000 (or fraction thereof) by which the taxpayer's adjusted gross income for the taxable year exceeds \$15,000, but not less than 20 percent. For example, if a taxpayer's adjusted gross income is \$31,850, the applicable percentage is 26 percent.

(3) Expenses may be taken as a credit under section 21, regardless of the taxpayer's method of accounting, only in the taxable year the services are performed or the taxable year the expenses are paid, whichever is later.

(4) The requirements of section 21 and §§ 1.21-1 through 1.21-4 are applied at the time the services are performed, regardless of when the expenses are paid.

(5) *Examples.* The provisions of this paragraph (a) are illustrated by the following examples.

Example 1. In December 2007, B pays for the care of her child for January 2008. Under paragraph (a)(3) of this section, B may claim the credit in 2008, the later of the years in